**Transcript of Remarks by Senate Budget Committee Chairman Kent Conrad (D-ND) at Hearing on the U.S. Economic Outlook with Federal Reserve Chairman Ben S. Bernanke January 7, 2011**

## Opening Statement

I want to welcome everyone to the Senate Budget Committee this morning. I especially want to welcome Senator Sessions. Senator Sessions has not formally been recognized as Ranking Member of the Budget Committee, but that's just a formality. He will be as soon as the organizing resolution is adopted.

And so I intend to treat Senator Sessions as the Ranking Member here today, and I think that's the appropriate thing to do. I very much welcome Senator Sessions as my partner on this committee. He has considerable knowledge of the budget and the budget process. And I very much look forward to working with him as we confront the significant challenges facing the country.

I also want to welcome Federal Reserve Chairman Ben Bernanke back to the Budget Committee. This is Chairman Bernanke's third appearance here. And we've always benefited by his wise counsel. I believe when the history of this period is written, that you will be one of the heroes of the piece in averting what could have been a financial collapse.

I was in the meetings with the former secretary of the treasury and with you when you warned us of how serious the financial circumstances were in late 2008. Those moments will be forever riveted in my memory, I'm sure in yours as well. I personally believe you and then Secretary of the Treasury Hank Paulson, followed by this administration, have taken steps that were critically important to averting a financial collapse, not only here, but globally as well.

Still, our nation faces very serious challenges. We know we are on an unsustainable course with the budget borrowing about 40 cents of every dollar that we spend. Clearly, that cannot continue for very long.

On the other hand, we also face a fragile economy. With one in every six workers in this country either unemployed or under-employed. That requires our immediate attention as well. My own belief is that we need to put in place the plan this year to get our fiscal house back in order. And that plan needs to be phased in over a period of time along the lines of what the Fiscal Commission proposed.

I think we also understand where we have come. This has been an extraordinary period in the country's economic history. I'd like to just go over a brief history of what we've experienced.

I personally believe the federal response did avert what could have been a financial collapse. I believe it was that serious. In the meetings that I was in with then Secretary of the Treasury Hank Paulson and you, Mr. Chairman, the risks were very clear.

We have seen some progress made, in fact, important progress made.  Private sector job growth has returned, although not as much as we would have liked.  We heard the numbers this morning, something over 100,000 jobs created in the private sector, a dramatic improvement from where we were back in January of 2009 when we were losing 800,000 private sector jobs a month.  Now we have had 12 consecutive months of private sector job growth.

And economic growth, the pattern is the same, although actually somewhat better.  In the fourth quarter of 2008, the economy actually contracted, actually shrunk by 6.8 percent.  More recently, in the third quarter of 2010, we saw positive growth of 2.6 percent, again a dramatic improvement, while not as strong as we would hope.  We have now had five consecutive quarters of growth.

We've also seen a dramatic rebound in the stock market after falling to a low of just about 6,500 in March of 2009.  But now the Dow is over 11,500.

And two of the most respected economists in the country, Mark Zandi, who was a consultant to the McCain campaign, and Alan Blinder, the former deputy chairman of the Federal Reserve, did an analysis that measured the impact of federal actions, the TARP and stimulus and also included the Fed's monetary policy actions.  And they concluded as follows: *"We find that its effects on real GDP, jobs and inflation are huge and probably averted what could have been called great depression 2.0.  When all is said and done, the financial and fiscal policies will have cost taxpayers a substantial sum, but not nearly as much as most had feared and not nearly as much as if policy makers had not acted at all.  If the comprehensive policy responses saved the economy from another depression, as we estimate, they were well-worth the cost."*

This next chart shows Dr. Blinder and Dr. Zandi's estimate of the number of jobs we would have without the federal response.  It shows we would have had 8 million fewer jobs in the second quarter of 2010 if we had not had the federal response, the TARP and the stimulus.

We see a similar picture with the unemployment rate.  The unemployment rate averaged 9.7 percent in the second quarter.  According to Dr. Blinder and Dr. Zandi, if we had not had the federal response, the unemployment rate would have been 15 percent in the second quarter and would have continued rising to over 16 percent in the fourth quarter of 2010.  So clearly, the federal response to the economic crisis has had and continues to have a significant positive impact on the economy.

But we are not out of the woods.  We can't forget that, as I mentioned before, one in every six of our fellow citizens are either unemployed or under-employed.  The unemployment rate in December, which was also announced this morning, was 9.4 percent.  This is still far too high.  And Federal Reserve projections show the rate is likely to come down only slowly, averaging still in the high 8 percentage point range by the fourth quarter of 2012.

But as I noted, we must now also pivot to addressing the long-term fiscal imbalances that the country confronts.  I believe we are at a critical juncture.  We have been borrowing, as I mentioned earlier, 40 cents of every dollar that we spend.  That cannot continue much longer.

Spending is at the highest level as a share of our national income in 60 years. Revenue is at its lowest level as a share of our national income in 60 years. I believe that indicates you've got to work both sides of that equation if we are to make progress.

Gross federal debt is already expected to reach 100 percent of GDP this year, well above the 90 percent threshold that many economists see as the danger zone. A leading economist came before our commission and has come before this committee, Dr. Carmen Reinhart, who has studied 200 years of fiscal crises around the world. She concluded that when government debt as a share of the economy exceeds 90 percent – and she's referring here to gross federal debt – that economic growth tends to be about 1 percentage point lower than it would be if debt levels were not so high. If that association replied to the United States today, it would translate into a potential economic loss of hundreds of billions of dollars and substantially fewer jobs for Americans.

I believe the deficit and debt reduction plan assembled by the fiscal commission could provide a blueprint and a way forward. The plan would stabilize the publicly-held debt by 2014. And then lower it to 60 percent of GDP by 2023 and roughly 30 percent by 2040. I emphasize that's the publicly-held debt, not the gross debt.

The bipartisan commission who voted for the plan, 60 percent of us supported it, interestingly enough, five Republicans and five Democrats and one independent. I think that demonstrates that we can reach across the aisle to do things that are critically important for the country. Facing up to the debt threat is something we must do, and we must do it together.

With that, we'll turn to Senator Sessions for his opening remarks. And, again, I want to welcome him as Ranking Member of the Budget Committee.

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**Excerpted Q&A**

*Chairman Conrad:* Thank you for your excellent testimony. And I want to go to your final point. This is the Budget Committee. We've got a special responsibility to our colleagues and the country to propose a fiscal policy going forward. What I hear you saying is that it's critically important that we adopt a credible plan, longer-term plan to deal with our deficits and debt. Is that an accurate understanding of what you're saying to us?

*Chairman Bernanke:* That's correct, Mr. Chairman. Our fiscal issues are very long-term in nature. They increase, the difficulties increase over time. Merely addressing this year's spending is not going to solve the problem. We need, we need to develop a plan, and a credible plan, one that markets will accept as plausible, to address the longer-term structural budget deficits that we face.

*Conrad:* The fiscal commission proposed a plan that would reduce the debt over time by $4 trillion, which would stabilize the debt in the short term, but importantly bring the debt down as a share of the economy to roughly publicly held debt to 30 percent of GDP. That's over an extended period of time. Is that about the magnitude, the size of plan that is necessary?

*Bernanke:* Senator, no one knows exactly what the desirable debt-to-GDP ratio is in the long run. You mentioned the 90 percent number as an upper level of comfort. I think, in the near term, I think we need to focus on stabilizing the debt-to-GDP ratio. And under the alternate scenario of the CBO, it just rises indefinitely, and that's certainly not sustainable.

If we could achieve, say, in the next decade, a 2 or 3 percentage point of GDP reduction in the deficit, that would be sufficient to bring the primary deficit close to zero and would stabilize the debt-to-GDP ratio over the next decade. We'd need additional steps after that. So I think stability is the first step; bringing it down is a bonus, if we can do that.

*Conrad:* You know, that was really the conclusion of the commission. The conclusion of the commission was the first job, job one is to stabilize the debt. At, you know, we talk about these different measures of debt. Publicly held debt is currently roughly 60 percent. The gross debt is currently about 90 percent. And most of the advice to the commission was, you've got to stabilize it, publicly held debt at 60 percent, gross debt at 90 percent. But over time, you really need to bring it down. You shouldn't stabilize it and consider that you've finished the job, because you need to have a margin to deal with future shocks. Is that your judgment, as well?

*Bernanke:* Yes, Mr. Chairman, but stabilizing it would be a very important first step.

*Conrad:* Job one, stabilize.

*Bernanke:* Right.

*Conrad:* Second question is, the timing of imposing the tough choices that need to be made here on both the spending side of the equation – and the commission proposed roughly $2.2 trillion of spending cuts, proposed nearly $1 trillion of new revenue. The rest of the savings was savings of interest.

In terms of when you pivot, that is a critical question. The commission's conclusion was, you ought not to take the really tough steps that need to be taken for the next several years. You need to begin. You need to adopt the plan. But the real tough medicine needs to wait until the economy is on stronger ground. What would your recommendation be to us?

*Bernanke:* Mr. Chairman, I think the issue is credibility. If we can, it's not really sufficient to say, "Well, we're not do anything now because the recession. We'll do something later, but we're not specifying what that is." I think if we could adopt a credible plan that's specific enough and credible enough to address the long-run situation, that would be the most positive thing that we could do. And in doing so, we could get really all the benefits without having to take actions that would endanger the very near-term recovery, which is still somewhat fragile.

*Conrad:* Yes, that was very much the conclusion of the commission. It's not enough to say, "Yeah, we're going to do something in the sweet by-and-by." You've actually got to adopt the plan. You know, you've got to put it in place. You've got to put it in place legislatively so people know, yeah, we are going to cut spending; we are going to improve the revenue base; we are going to have savings of interest costs. And it's got to be credibly scored; it's got to be real. But it shouldn't, you shouldn't have the bite occur too soon or you endanger this fragile recovery.

You made another set of comments that I thought was very important, and that was the composition of the spending reductions. The composition of the revenue is also critically important to future economic growth. You're saying, look, you've got to pay attention to human capital, education. You've got to pay attention to infrastructure, because that improves the economic competitive position of the United States.

But when you are imposing these spending cuts, you've got to go after things that are superfluous – and, goodness knows, as we look across federal spending, there are places we're not doing things that enhance economic growth. There are things that constitute waste – although the idea that just cutting waste, fraud, and abuse is going to solve this problem is – I wish it were the case – but it's necessary, but not sufficient.

On the revenue side, the commission concluded one of the best things we could do is broaden the tax base, eliminating some of the tax expenditures, but simultaneously reducing rates to make America more competitive. Is that what you had in mind when you talked about paying attention to the composition of the changes that are made?

*Bernanke:* Yes, Mr. Chairman. On the first point, the national income accounts don't really distinguish between government consumption and investment very sharply. I mean, there is a technical distinction. But we need to think about making investments for the future as opposed to simply spending on the -- spending our seed corn on current needs. And so thinking about government programs, we should ask the question, will this provide benefits in the future, provide a more productive, competitive economy in the future?

On the tax side, I don't think it's really very controversial among economists that rising rates combined with the multiplication of exemptions, deductions, credits and so on leads to a tax code which is very complex and can distort economic decisions. And I think all of the major deficit reduction commissions have taken the opportunity to talk about the need to lower rates, but to avoid, but to close loopholes so as not to lose revenue. So I think that is something I hope that the Congress will talk about.

It's not at all inconsistent that both address the long-term deficit issues, but also to think about, you know, making our tax code and our spending priorities more growth-friendly.

*Conrad:* I'll tell you, there's nobody that could have participated in this process that didn't conclude this tax system that we have is just completely out of date. You know, it does not take account of the world that we live in today.

The other conclusion of the commission was that you've got to have everything on the table. Spending, revenue and every part of federal spending has to be dealt with, and, you know, even defense. One of the most startling, I'd say to my colleagues, one of the most startling pieces of information that came to the commission was 51 percent of the federal workforce is at the Department of Defense.  That does not count the contractors.  When we asked the defense analysts who came before the commission, "How many contractors does the Department of Defense have?" they told us they couldn't tell us.  Not because it was secret, but because they did not know.  When we asked them what was the range, they said between 1 million and 9 million.  That's a pretty broad range.  So we've got issues throughout the federal government, and we're going to have to address them.

I very much appreciate the good advice that you've given us.  Thank you.